North Borneo Timbers Bhd v Ketua Pengarah Hasil Dalam Negeri

HIGH COURT (KOTA KINABALU) — MISC APPEAL NO K 02 OF 1997
CHARLES HO J
10 SEPTEMBER 1998

Revenue Law *— Income tax — Deduction — Whether outgoings and expenses incurred in production of income — Value of unused obsolete spare parts written off — Claim for deduction does not fall within s 33(1)(c) — Whether entitled to fall back on general provisions of s 33(1) — Income Tax Act 1967 s 33(1) & (c)*

The appellant appealed against the decision of the Special Commissioners of Income Tax in holding that the sum representing the value of unused obsolete spare parts written off by the appellant was not deductible under the provisions of s 33(1)(c) of the Income Tax Act 1967 ('the Act'). It was held that s 33(1)(c) only allows deduction from the gross income outgoings and expenses incurred for the repair of plant or machinery employed in the production of gross income. The appellant had based its arguments before the Special Commissioners on: (i) the general provisions of s 33(1); and (ii) the provisions of s 33(1)(c). The appellant contended that the Special Commissioners had failed to deal with the argument under the general provisions of s 33(1).

Held, allowing the appeal:

Strictly construed and on a proper interpretation, s 33(1)(c) only allows deduction in respect of repairs actually incurred. Therefore, the court agreed with the Special Commissioners that the appellant's claim for deduction did not fall within s 33(1)(c).

However, the appellant was entitled to fall back on the general provisions of s 33(1) if it failed to bring its case within the specific provisions of s 33(1)(c). In order to qualify for deduction under s 33 of the Act, it is not necessary that a taxpayer must show that the expenses and outgoings for which a claim for deduction is made fall within one of the expenses and outgoings specifically mentioned in paras 33(1)(a) to (d) of the section. The taxpayer is only required to show that such outgoings and expenses were actually incurred wholly and exclusively during that period in the production of gross income. In the present case, it was necessary for the appellant to maintain a stock of spare parts for the maintenance and repair of its machinery and mobile equipment for timber operations. Based on the undisputed facts, the claim for deduction of the appellant came within the general provisions of s 33(1), ie as outgoings and expenses wholly and exclusively incurred during that period by the appellant in the production of gross income (see pp 712D, 713E and 714F–H).

A **[Bahasa Malaysia summary**

Perayu telah merayu terhadap keputusan Pesuruhjaya Khas Cukai Pendapatan dalam memutuskan bahawa jumlah yang mewakili nilai alat-alat ganti lapuk yang tidak digunakan yang telah dihapus kira oleh perayu tidak boleh ditolak di bawah peruntukan s 33(1)(c) Akta Cukai Pendapatan 1967 ('Akta tersebut'). Telah diputuskan bahawa s 33(1)(c) hanya membenarkan potongan daripada pendapatan kasar wang keluar dan perbelanjaan yang ditanggung bagi kerja-kerja pembaikan logi atau jentera yang digunakan dalam penghasilan pendapatan kasar. Perayu telah mengasaskan penghujahannya di hadapan Pesuruhjaya Khas atas: (i) peruntukan am s 33(1); dan (ii) peruntukan s 33(1)(c). Perayu telah menegaskan bahawa Pesuruhjaya Khas telah gagal untuk bertindak atas penghujahan tersebut di bawah peruntukan am s 33(1).

Diputuskan, membenarkan rayuan:

Mentafsirkan dengan tegasnya dan atas interpretasi yang sempurna, s 33(1)(c) hanya membenarkan potongan berhubung dengan kerja-kerja pembaikan yang sebenarnya ditanggung. Dengan itu, mahkamah bersetuju dengan Pesuruhjaya Khas bahawa tuntutan perayu untuk potongan tidak terlingkung di dalam s 33(1)(c).

Walau bagaimanapun, perayu boleh berpaling kepada peruntukan am s 33(1) jika ia gagal untuk mengemukakan kesnya di dalam lingkungan peruntukan-peruntukan spesifik s 33(1)(c). Untuk layak bagi mendapatkan potongan di bawah s 33 Akta tersebut, adalah tidak perlu bagi pembayar cukai menunjukkan bahawa perbelanjaan dan wang keluar bagi sesuatu tuntutan untuk potongan adalah terlingkung di bawah salah satu perbelanjaan dan wang keluar yang disebut secara khususnya dalam perenggan 33(1)(a) hingga (d) seksyen tersebut. Pembayar cukai hanya dikehendaki menunjukkan bahawa wang keluar serta perbelanjaan-perbelanjaan yang sedemikian sebenarnya ditanggung secara keseluruhan dan eksklusif dalam tempoh ketika penghasilan pendapatan kasar. Dalam kes ini, adalah perlu bagi perayu mengekalkan stok alat-alat ganti untuk penyenggaraan dan pembaikan jenteranya serta peralatan mudah alih untuk operasi-operasi kayu balak. Berdasarkan fakta-fakta yang tidak dipertikaikan, tuntutan untuk potongan oleh perayu terlingkung di bawah peruntukan-peruntukan am s 33(1), iaitu sebagai wang keluar dan perbelanjaan yang ditanggung secara keseluruhan dan eksklusif ketika tempoh itu oleh perayu dalam penghasilan pendapatan kasar (lihat ms 712D, 713E dan 714F–H).]

Notes

For cases on deduction, see 10 *Mallal's Digest* (4th Ed, 1996 Reissue) paras 1796–1822.

Cases referred to

Chin Choy & Ors v Collector of Stamp Duties [1979] 1 MLJ 69 (refd)
Comptroller of Income Tax v X Rubber Co Ltd [1961] MLJ 191 (refd)
Director General of Inland Revenue v Rakyat Berjaya Sdn Bhd [1984] 1 MLJ 248 (refd)
Guinea Airways Ltd v General Commissioners of Taxation 83 CLR 589 (refd)
Odeon Associated Theatres Ltd v Jones (HM Inspector of Taxes) 48 TC 257 (refd)

Legislation referred to

Income Tax Act 1967 s 33(1)(a), (b), (c), (d)
Income Tax Assessment Act 1936–1942 s 51(2) [Australia]

WSW Davidson (*Azman, Davidson & Co*) for the appellant.
Khairuddin bin Abdullah (*Salmah Kassim* with him) (Legal Officers) for the respondent.

Cur Adv Vult

Charles Ho J: This is an appeal by way of case stated against the decision of the Special Commissioners of Income Tax in holding that, in the assessment of the taxpayer company's income for the year of assessment 1984, the sum of RM96,732 representing the value of unused obsolete spare parts written off by the taxpayer company was not deductible under the provisions of s 33(1)(c) of the Income Tax Act 1967.

When the appeal first came before me on 22 August 1997, Mr Davidson, counsel for the taxpayer company informed the court that he had raised two arguments before the Special Commissioners: (a) under the general provision of s 33(1); and (b) under the provisions of s 33(1)(c) of the Act. As the Special Commissioners only dealt with the argument under s 33(1)(c) in disallowing the taxpayer company's claim for deduction and did not state whether or not the general provisions of s 33(1) was applicable to the taxpayer company's case, the matter was remitted to the Special Commissioners for a supplementary case to be stated based on the general provisions of s 33(1).

The Special Commissioners now say that they have already considered all the arguments raised by counsel for the taxpayer company in coming to their decision not to allow the deduction. In their supplementary case stated, they merely state:

> In para 7 of our case stated, we stated that the contention of the appellant was that the amount of RM96,732 written off should be allowed as deduction for income tax purposes under s 33(1)(c) of the Income Tax Act 1967 whilst in para 8 of our case stated we stated that the respondent's contention was that the said amount should not be allowed as deduction under s 33(1)(c) of the Income Tax Act 1967.
>
> In para 10 of the case stated are our reasons for arriving at our decision that the appellant's appeal must fail. The reasons hinge solely on the

A interpretation of s 33(1) of the Income Tax Act 1967 and specifically para (c). We have considered the arguments for the appellant and even the cases cited in relation to s 33(1) of the Income Tax Act 1967.

With respect, we have nothing more to add and state that we have considered the arguments and stand by our reasoning given in para 10 of the case stated.

B Mr Davidson thinks that the Special Commissioners have failed to deal with the argument under the general provisions of s 33(1). With respect, I fully agree with him. We do not have therefore the benefit of the considered opinion of the Special Commissioners on this issue. It appears to me the Special Commissioners did not seem to fully appreciate that the C taxpayer company in the present case is entitled to fall back on the general provisions of s 33(1) if it fails to bring its case within the specific provisions of s 33(1)(c). In order to qualify for deduction under s 33 of the Act, it is not necessary that a taxpayer must show that the expenses and outgoings, for which a claim for deduction is made, fall within one of the expenses D and outgoings specifically mentioned in paras 33(1)(a) to 33(1)(d) of the section. The taxpayer can rely on the general provisions of that section to claim for deduction if the taxpayer is able to show that such outgoings and expenses are actually incurred wholly and exclusively during that period in the production of gross income. In *Director-General of Inland Revenue v Rakyat Berjaya Sdn Bhd*, the Federal Court held:

E

(1) Interest on a debt owing, as opposed to a debt for money borrowed, cannot be deducted under s 33(1)(a) of the Income Tax Act but can be so deducted under the opening part of s 33(1) as one of the 'outgoings and expenses wholly and exclusively incurred during the period by that person in the production of gross income from that source'.

F The facts admitted or proved set out at pp 2–4 of the case stated are as follows:

(a) The appellant's activities were logging and export of logs, manufacturing and plantation.

G (b) The timber logging activity ceased in 1985.

(c) For carrying on timber logging activity, the appellant had to maintain a large fleet of heavy mobile equipment, three factories with machineries and quarters for workers at three logging camps. For the camps, the appellant had to supply free electricity, water, recreational facilities and a clinic with free medical services.

H (d) In order to ensure continuous logging activities, the appellant had to stock spare parts for the machineries and mobile equipment. These spare parts were imported mainly from Canada and the USA.

(e) When spares were purchased, the appellant debited 'Stocks of Spares' and credited 'Cash' and when the spares were utilised, the appellant I debited 'Repairs and Maintenance' and credited 'Stocks of Spares'.

(f) Some machineries and heavy equipment were superseded or ran out of their useful life and as a result the related spares which were in stock had to be written off. Exhibit 'A2' lists out all the written off spares with a total value of RM96,733.05.

(g) For the Year of Assessment 1984, the respondent issued a Computation of Repayment dated 10 June 1988 showing RM1,939,501 as tax payable and a refund of RM60,499 by the respondent.

(h) The appellant filed an appeal against the Computation of Repayment. Form Q dated 12 July 1988 was filed citing the following grounds:

> That an amount of RM96,732 written off in respect of obsolete stock for consumable stores and spare parts used by the company to maintain and service income-producing plant and equipment for timber operations had been denied as a deduction for income tax purposes under s 33(1)(c) of the Income Tax Act.
>
> The total tax repayable should be RM99,631.20 instead of RM60,499.

The Special Commissioners also accepted the evidence of the only witness called at the hearing by the taxpayer company. AW1 was the Group Chief Accountant of the taxpayer company and his evidence was as follows:

(i) The appellant carried on amongst others logging activity at least since 1974, when AW1 joined the appellant as the Group Chief Accountant and this activity only ceased in 1985.

(ii) In order to carry on the said activity the appellant had to maintain heavy machineries and equipment and to ensure continuous operation, there was a need to stock spare parts which were obtainable from Canada and the USA and it took at least 4–6 months for these items to arrive when ordered.

(iii) When the machineries and equipment were superseded or their life span expired, there were unused spare parts which the appellant had to write off.

(iv) The written off value of the unused spare parts came up to RM96,732 and it is this sum that the appellant is requesting for deduction as expenses under s 33(1)(c) of the Act.

The reasons given by the Special Commissioners for their decision that the taxpayer company were not entitled to claim deduction under s 33(1)(c) are to be found at pp 9–10 of the case stated:

> (g) Sub-s (1)(c) of s 33 is very clear, it only allows deduction from the gross income outgoings and expenses incurred, inter alia, for the repair of plant or machinery employed in the production of gross income.
>
> (h) Counsel for the appellant referred to six cases and in our opinion amongst the cases cited, the case of *The Comptroller of Income Tax v X Rubber Co Ltd* [1961] MLJ 191 (where the replacement of a gate contributed to revenue expenditure and hence deduction was allowed) is the most relevant. In this case the replacement of the gate was 'a repair of premises, such premises being the whole drainage system of the ten watergates, and the construction of the single watergate, taken by itself, was not an independent entity which could be said to create any new asset and as a consequence the cost of the construction of such watergate ought to be regarded as income expenditure'.
>
> (i) From the facts of this case, the provision of s 33(1)(c) of the Act and authorities cited, it is our considered opinion that the amount written

A off for the unused spare parts cannot fall under s 33(1)(c) of the Act for the reason the amount written off was not expended for the repair of the machinery or equipment for the production of income. It is not denied that the spare parts were purchased but they were kept in stock as reserves and were never used for the repair of machinery or equipment necessary for the production of income.

B The provisions of the Income Tax Act 1967, relevant to this appeal read:

> 33 (1) Subject to this Act, the adjusted income of a person from a source for the basis period for a year of assessment shall be an amount ascertained by deducting from the gross income of that person from that source for that period all outgoings and expenses wholly and
> C exclusively incurred during that period by that person in the production of gross income from that source, including —
>
> ...
>
> (c) expenses incurred during that period for the repair of premises, plant, machinery or fixtures employed in the production of gross income from that source or for the renewal, repair or alteration of
> D any implement, utensil or article so employed, other than implements, utensils, articles (the expenditure on which would be qualifying plant expenditure for the purposes of Schedule 3) or any means of conveyance, excluding the cost of reconstructuring or rebuilding.

E It is submitted by Mr Davidson that the Special Commissioners construed s 33(1)(c) too narrowly in that they confined it to expenditure actually incurred in carrying out physical repairs. According to counsel, this section should be given a more purposive construction, ie to include expenses incurred with the view to the carrying out of future repairs. Counsel,
F however, has not cited any authority to show that such an approach has been adopted by the court here or in other jurisdictions. It is a general rule that a taxing statute should be construed strictly. There is no lack of authorities touching on the principles and rules to be applied in the construction of statutes. For the purposes of the present appeal, I think it is sufficient to just cite the often quoted passages from the judgment of our
G Federal Court in *Chin Choy & Ors v Collector of Stamp Duties* [1979] 1 MLJ 69 at p 70:

> It may be apposite at this stage to recall certain basic principles in the interpretation of statutes. Applying the words and phrases of a statute in their ordinary meaning has been said to be the first and most elementary
> H rule of construction and the second is said to be to construe the phrases and sentences according to the rules of grammar.
>
> > 'It is very desirable in all cases to adhere to the words of an Act of Parliament, giving to them that sense which is their natural import in the order in which they are placed,'
>
> (per Bayley J in *R v Ramsgate (Inhabitants)* (1827) 6 B & C 712). We bear
> I in mind the well-settled rule of law that all changes upon the subject must be imposed by clear and unambiguous language (see *Maxwell on the Interpretation of Statutes* (11th Ed) at p 278), but this rule of law also means that where the language of an Act of Parliament clearly imposes a charge, then the court fastened with the duty not merely to interpret that Act but also to apply the law, must give expression to the will of Parliament.

> 'In a Taxing Act, one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used,'

(per Rowlatt J in *Cape Brandy Syndicate v IRC* [1921] KB 24, approved by Viscount LC in *Canadian Eagle Oil Co v R* [1946] AC 119). Or as expressed in *Maxwell's Interpretation of Statutes* at pp 4–5:

> 'The underlying principle is that the meaning and intention of a statute must be collected from the plain and unambiguous expression used therein rather than from any notions which may be entertained by the court as to what is just and expedient .... However unjust, arbitrary or inconvenient the meaning conveyed may be, it must receive its full effect. When once the meaning is plain, it is not the province of a court to scan its wisdom or its policy. Its duty is not to make the law reasonable, but to expound it as it stands, according to the real sense of the words.'

I do not think there is any ambiguity in the words and meaning of s 33(1)(c). Strictly construed and on a proper interpretation, the section only allows deduction in respect of repairs actually incurred. I would, therefore, with respect, agree with the Special Commissioners that the taxpayer company's claim for deduction does not fall within s 33(1)(c).

Having decided that the deduction did not fall under s 33(1)(c), I have now to consider the second argument raised by the taxpayer company, that is, whether the sum of RM96,732 representing the value of the spare parts written off qualify for deduction under the general provisions of s 33(1). In other words, whether the said sum of money could rightly be considered as 'outgoings' and expenses wholly and exclusively incurred in the production of gross income. The contention of Mr Davidson is, in effect, that the writing off of unused or obsolete spare parts in the present case is an 'outgoing' based on accepted accounting principle which is analogous to the writing-off of bad debts. Counsel says that the taxpayer company could have rightly claimed for deduction immediately after the purchase of the spare parts under s 33(1)(c) or s 33(1), but instead only claimed for deduction when the spares are actually taken out of stocks and used in the machine or when they became obsolete. In support of his contention, counsel referred the court to a paragraph in the judgment of his Lordship, Buckley LJ in *Odeon Associated Theatres Ltd v Jones (HM Inspector of Taxes)* 48 TC 257 (p 38 of bundle of authorities) which reads:

> The question (whether a particular outlay can be set against income or must be regarded as a capital outlay) is ultimately a question of law for the court, but it is a question which must be answered in light of all the circumstances which it is reasonable to take into account, and the weight which must be given to a particular circumstance in a particular case must depend rather on common sense than on strict application of any single legal principle.
>
> In answering that question of law, it is right that the court should pay regard to the ordinary principles of commercial accounting so far as applicable. Accountants are, after all, the person best qualified by training and practical experience to suggest answers to the many difficult problems that can arise in this field. Nevertheless, the question remains ultimately a question of law. No one, I think, would dispute that the cost of ordinary current repairs in the normal course of maintenance of a fixed capital asset

A employed in a business is revenue expenditure. Such cost arises out of the wear and tear of the asset in the course of earning the profits of the business and so is a proper debit to be set against the revenue of the business in its profit and loss account.

As for the meaning of the word 'outgoings', counsel submits that it has a B wider meaning than the word 'expenses'. Counsel cited a paragraph from the book titled *Malaysian Taxation* by Chin Yoong Kheong in which the author said:

> The word 'outgoings' has a wider meaning than the word 'expenses'. The former does not necessarily involve a cash outlay or a paying out of money. For example, the cost of samples given out in marketing a product is C covered by the general term 'outgoings'. Another example of outgoings is specific bad debts. In claiming a deduction for specific bad debts, one does not claim that one has spent money.

Like the Special Commissioners, counsel for revenue does not seem to fully appreciate that the taxpayer company is relying not only on s 33(1)(c) D but also on the general provisions of s 33(1) and it is necessary to consider Mr Davidson's two arguments separately. This is evident in para 10 of the written submission (read out in court) prepared by counsel for revenue:

> Its trite law that in order to qualify for a deduction under s 33(1) an expenditure must have been wholly and exclusively incurred in the production E of gross income. The question whether the requirement that the expenditure must have been wholly and exclusively incurred also applies to expenses for the repair of premise, plant and machineries of fixture employed in the production of gross income under s 33(1)(c). The use of the word 'including' at the end of s 33(1) means that the section is not exhaustive. As the word 'including' in effect means 'and the following', what it means is that what is F set out after that word is something which would not normally fall when the main word of the section. The s 33(1)(c) is not governed by the requirement of the expenditure having been wholly and exclusively incurred appearing in s 33(1). Section 33(1)(c) stands on its own unaffected by the requirements of s 33(1). Section 33(1)(c) must be read as a proviso to s 33(1). Anything in s 33(1) which is inconsistent with s 33(1)(c) must be deemed not to G apply. The corollary is that the expenses incurred for the repair of machineries can only fall under s 33(1)(c) and not under s 33(1).

One of the authorities cited by counsel for revenue, ie *Guinea Airways Ltd v General Commissioners of Taxation* 83 CLR 589, is of particular assistance to the court. Counsel says that she relies mainly on that case as the facts H were similar to the facts in the present appeal. In that case, *Guinea Airways Ltd* was an air transport company operating in New Guinea. It carried on the business of transporting passengers and goods by air in Papua New Guinea. The company's building stores and equipment were destroyed. Among the properly destroyed were large quantities of spare parts which it maintained for the maintenance and repair of its aeroplanes. The spare I parts destroyed were valued at £25,361. The War Damage Commission awarded the company an amount of £19,570 in respect of the spares under the National Security (War Damage to Property) Regulations. The difference of £5,791 the company claimed to deduct from its assessable income in arriving at the taxable income of the accounting period. The Commissioner for Taxation disallowed the claim and an appeal from the

disallowance was dismissed by Dixon J. From this decision, the company appealed to the High Court of Australia (Full Court). The appeal was dismissed by the High Court which held that the loss was a loss of a capital nature and therefore was not deductible under s 51(1) of the Income Tax Assessment Act 1936–1942 which allowed deductions for 'all losses and outgoings to the extent to which they are incurred in gaining or producing the assessable income, or are necessarily incurred in carrying on a business for the purpose of gaming or producing such income'.

It is submitted by Mr Davidson that *Guinea Airways*' case can be distinguished from the present appeal on the facts. It is pointed out by counsel that the decision in *Guinea Airways*' case was essentially based on the facts as stated by Latham CJ at p 590 of his Lordship's judgment:

> It is, however, clear that the assets in question had not in fact been so used. What was destroyed was a large stock of assets, much greater than, according to the facts before the court any annual quantity which was intended to be used in the maintenance and repair of the aircraft of the company.
>
> The provision of these stocks of goods does not represent incidents in the carrying on of the enterprise of the company from day to day whereby it earned its income. As I have already said, so far as the spare parts, etc. were actually used in repairing , etc aeroplanes, their cost would be deductible. But the cost of maintaining a large stock which, though it probably represents a wise policy, is beyond any requirements for prospectively immediate use cannot, in my opinion, be regarded as an expenditure properly chargeable to income account. It represents, in my opinion, an expenditure of the capital of the company in procuring an asset to be used in the future in carrying on the income-earning enterprise of the company. Accordingly, I agree with Dixon J that the claim for the deductions was properly disallowed by the commissioner.

With respect, I agree with Mr Davidson that the undisputed facts in the present appeal are quite different from the facts in *Guinea Airways*' case. As mentioned earlier, it was necessary for appellant company in this appeal to maintain a stock of spare parts for the maintenance and repair of its machineries and mobile equipment for timber operations. There was also no suggestion that the quantity of spare parts maintained by the appellant company was unnecessarily large and more than what was intended to be used for the maintenance of machineries and equipment for timber operations.

Based on the undisputed facts in this case and for reasons given above, I am of the opinion that the claim for deduction of the appellant company in the present case comes within the general provision of s 33(1), that is, as outgoings and expenses wholly and exclusively incurred during that period by the appellant company in the production of gross income. I would accordingly allow the appeal with costs.

Appeal allowed with costs.

Reported by Jafisah Jaafar